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90-1939

No. _____

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

GILBERT and VIRGINIA CARTER,
Petitioners,

v.

DIRECTOR OF REVENUE,
STATE OF MISSOURI,
Respondent.

PETITION FOR WRIT OF CERTIORARI
TO THE SUPREME COURT OF MISSOURI

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. For tax year 1987, was Missouri's imposition of its income tax on portions of Petitioners' social security benefits, which portions they had included in their Federal gross income in compliance with Internal Revenue Code (IRC) §86, while it exempted from such tax the retirement benefits provided by its own state and political subdivision retirement systems, and Tier I railroad retirement benefits, repugnant to the equal protection clause of the Fourteenth Amendment of the U.S. Const., or to the intergovernmental tax immunity doctrine, or both?

2. Was Missouri prohibited by Social Security Act §207 (42 U.S.C. §407) from imposition of its income tax on those social security benefit portions?

3. Did IRC §86 by taxing those benefit portions, to the extent it did so only by operation of Subsection (b)(2)(B) requiring inclusion of tax-exempt interest

in "modified adjusted gross income", deprive Petitioners pro tanto of their IRC §103 exemption in violation of the equal protection component of the due process clause of the Fifth Amend. of the U. S. Const., or the intergovernmental tax immunity doctrine, or both?

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DIRECTOR OF REVENUE,
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Respondent.

PETITION FOR WRIT OF CERTIORARI
TO THE SUPREME COURT OF MISSOURI

Petitioners ask that a writ of certiorari issue to review the Judgment and Opinion of the Supreme Court of Missouri, entered in this case.

OPINIONS BELOW

The Opinion of the Missouri Supreme Court (App. 1-20) is reported at 805 S.W.2d 154. The decision of the Administrative Hearing Commission (App. 20-23) is unreported.

JURISDICTION

The Judgment of the Missouri Supreme Court (App. 19, 20) incorporated in its Opinion, was entered March 5, 1991. Petitioners timely filed on March 18, 1991 a Motion for Rehearing which was overruled by Order of that Court (App. 20) entered April 9, 1991. The jurisdiction to review that Judgment is conferred on this Court by 28 U.S.C. §1257.

More specifically, if required by Rule 14.1.(e), the grounds on which jurisdiction is invoked in this case (for tax year 1987) are:

(1) The validity of the Missouri Income Tax Law (RSMo Chap. 143) in particular RSMo §143.121 providing in part that "The Missouri adjusted gross income of a resident individual shall be his Federal adjusted gross income subject to the modifications in this section." without making any provision for subtraction or exclusion of any social

security benefits, is drawn in question as being repugnant to the equal protection clause of the Fourteenth Amend. of the U. S. Const., the intergovernmental tax immunity doctrine and 42 U.S.C. §407.

(2) The validity of 26 U.S.C. §86(b)(2)(B), in its discriminatory denial of the general application otherwise of 26 U.S.C. §103, is drawn in question as being repugnant to the equal protection component of the due process clause of the Fifth Amend. of the U. S. Const.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The U. S. Const. Amend. 14 §1 provides in relevant part:

> No State shall * * * deny any person within its jurisdiction the equal protection of the laws.

U. S. Const. Amend. 5 provides in relevant part:

> No person shall * * * be deprived of * * * property, without due process of law; * * *.

U. S. Const. Art. VI, Clause 2 provides in relevant part:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof * * * shall be the supreme Law of the Land and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

42 U.S.C. §407 states:

> (a) The right of any person to any future payment under this title shall not be transferable or assignable, at law or in equity, and none of the monies paid or payable or rights existing under this title shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.
>
> (b) No other provision of law, enacted before, on, or after the date of the enactment of this section, may be construed to limit, supersede, or otherwise modify the provisions of this section except to the extent that it does so by express reference to this section.
>
> (By P.L. 98-21, enacted April 20, 1983 the then existing

provisions of §407 were designated Subsection (a), and Subsection (b) was added.)

45 U.S.C. 231m, of the Railroad Retirement Solvency Act of 1983, in relevant part provides:

> Section 231m. **ASSIGNABILITY: EXEMPTION FROM LEVY.**
>
> (a) Except as provided in Subsection (b) of this section and the Internal Revenue Code of 1954, notwithstanding any other law of the United States, or of any state, territory, or the District of Columbia, no annuity or supplemental annuity shall be assignable or be subject to any tax or to garnishment, attachment, or other legal process under any circumstances whatsoever, nor shall the payment thereof be anticipated.
>
> (b) (1) This section shall not operate to exclude the amount of any supplemental annuity paid to an individual under §2(b) of this Act from income taxable pursuant to the Federal income tax provisions of the Internal Revenue Code of 1954.

(Subsection (b)(2) provides an exception for community property, unrelated to taxation thereof,

not here involved.)

RSMo §143.121 in relevant part provides:

> The Missouri adjusted gross income of a resident individual shall be his Federal adjusted gross income subject to the modifications in this section. (It does not mention social security benefits.)

Section 86 of the Internal Revenue Code of 1986 in relevant part provides:

> **Sec. 86. Social security and tier I railroad retirement benefits.**
>
> **(a) In general.**
>
> Gross income for the taxable year of any taxpayer described in subsection (b) includes (notwithstanding section 207 of the Social Security Act) social security benefits in an amount equal to the lesser of-
>
> (1) one-half of the social security benefits received during the taxable year, or
>
> (2) one-half of the excess described in subsection (b)(1).
>
> **(b) Taxpayers to whom subsection (a) applies.**
>
> (1) **In general.** A taxpayer is

described in this subsection if-

(A) the sum of-

(i) the modified adjusted gross income of the taxpayer for the taxable year, plus

(ii) one-half of the social security benefits received during the taxable year, exceeds

(B) the base amount.

(2) Modified adjusted gross income. For purposes of this subsection, the term "modified adjusted gross income" means adjusted gross income

(A) determined without regard to this section and sections 911, 931, and 933, and

(B) increased by the amount of interest received or accrued by the taxpayer during the taxable year which is exempt from tax.

(c) Base amount. For purposes of this section, the term "base amount" means-

(1) except as otherwise provided in this subsection, $25,000,

(2) $32,000, in the case of a joint return, and * * *

(d) Social Security benefit.

(1) **In General.** For purposes of this section, the term "social security benefit" means any amount received by the taxpayer by reason of entitlement to-

> (A) a monthly benefit under title II of the Social Security Act, or
>
> (B) a tier 1 railroad retirement benefit. * * *

(4) **Tier I railroad benefit.** For purposes of paragraph (1), the term "tier 1 railroad retirement benefit" means-

> (A) the amount of the annuity under the Railroad Retirement Act of 1974 equal to the amount of the benefit to which the taxpayer would have been entitled under the Social Security Act if all of the service after December 31, 1936, of the employee (on whose employment record the annuity is being paid) had been included in the term "employment" as defined in the Social Security Act, and
>
> (B) a monthly annuity amount under section 3(f)(3) of the Railroad

Retirement Act of 1974.
* * *

Section 103 of the Internal Revenue Code of 1986 in relevant part provides:

> **Sec. 103. Interest on State and local bonds.**
>
> **(a) Exclusion.**
>
> Except as provided in subsection (b), gross income does not include interest of any State or local bond.
>
> **(b) Exceptions.** (Are not here involved.)
>
> **(c) Definitions.**
>
> For purposes of this section * * *-
>
> > **(1) State or local bond.** The term "state or local bond" means an obligation of a State or political subdivision thereof. * * *

STATEMENT OF THE CASE

The facts are undisputed. For tax year 1987, Petitioners, as husband and wife and residents of Missouri, filed joint Federal and combined Missouri income tax

returns, including in their Federal gross (and adjusted gross and taxable) income a $8,748 portion (1/2) of their combined social security benefits, in compliance with IRC §86, but excluding that portion from their Missouri adjusted gross income. Respondent disallowed that exclusion. Petitioners are seeking recovery of $518.60, representing Missouri income tax they paid solely as a result of that disallowance. In the alternative, if they are not entitled to that entire exclusion, they ask for $354.60 representing tax overpayment based on inclusion of a $2,841 (reduced) benefits portion that would have been included in income as called for by IRC §86 had it not required adjusted gross income to be increased by the amount of their tax-exempt interest in arriving at their "modified adjusted gross income". The parties have stipulated in the ABBREVIATED/PARTIAL RECORD ON APPEAL, (App. 23, 24, 25) those computations and figures

are correct, also that on either overpayment amount interest would be recoverable from April 15, 1988 at the rate determined pursuant to RSMo §32.065, as provided in RSMo §143.811.1.

Those and other (largely technical and tedious) facts are stipulated in agreed statements serving as the Record on Appeal (App. 23 et seq.) mostly to show timely compliance with administrative and appellate procedural requirements, and to some extent are reflected in the Missouri Supreme Court Opinion (App. 2) and the Administrative Hearing Commission's Decision (App. 21 et seq.); all of which serve also to show that the federal questions Petitioners seek to have reviewed were timely and properly raised, first in their claim for refund and the protest of its denial, then in the Commission and thereafter in the Missouri Supreme Court, which actually was the court of first

instance, since the facts were undisputed and, as is noted in the Commission's "Memorandum Decision" (App. 22) it lacked jurisdiction to decide those questions.

Petitioners have abandoned (as they did in their Motion for Rehearing in the Missouri Supreme Court) and do not seek review of the contentions addressed in the concluding parts E. F. of that Court's Opinion (App. 16-19) involving Mo. Const. Art. III §1 and Art. X, §4(d) and 18.

REASONS FOR GRANTING WRIT

The court below decided several important questions of Federal law that have not been, but should be, settled by this Court; questions that involve Federal Constitutional and statutory law and were decided in ways that conflict with applicable decisions of this Court. By conservative estimate, many thousands of individual taxpayers are interested in those questions, and their tax liabilities

to a substantial extent depend on how they are resolved, so they need and deserve to have them authoritatively determined by this Court. A study (App. 31) estimated for a single year $15,786,000.00 of taxes on Social Security benefits was paid to Missouri which, divided by Petitioners' $518.60 (supra page 10) as an average amount would show 30,440 Missouri taxpayer couples interested and affected. At least twelve other states tax Social Security benefits by starting with Federal adjusted gross income, and additional states may tax them by some other method.

ARGUMENT

A

The State of Missouri in taxing Social Security retirement benefits while exempting retirement benefits under its State and political subdivision retirement systems (App. 3, Opinion below) and the Railroad Retirement Act (App. 32,

Supplemental Record) violates both equal protection and the intergovernmental tax immunity doctrine. Since both are based on principles of fairness and equal treatment and their requirements are the same or practically so, except the latter involves also a consideration of the Government's interests, they are treated herein together. For an understanding of the immunity doctrine's application to this case, probably all that is required is perusal of the excellent treatment in **Davis v Michigan, 489 US 803,** at 810-813 of the history and evolution of the doctrine, concluding with a reference to the "modern" Constitutional doctrine permitting only "nondiscriminatory" state taxation.

From **Davis v Michigan, supra,** there is far more to be gleaned than its adjudication, within the narrow confines of 4 USC §111, of the statutory construction issue there involved. That completely

eluded the court below, which, in its opinion (App. 4) said **Davis** rested on principles of immunity "mandated by Federal statute." and did not rest on equal protection, thereby ignoring what this Court said (489 US at 14) concluding with the statement:

> Thus, the dispositive question in this case is whether the tax imposed on Appellant is barred by the doctrine of intergovernmental tax immunity.

which indicates clearly the statute was simply a codification of constitutional principles this Court applied in making a decision that readily would have been reached had the statute never been enacted.

This Court said, in **Farmers Loan and T. Co. v. Minnesota, 280 US 204, 212** "Taxation is an intensely practical matter * * *"; and in **Commissioner v Southwest Exploration Company 350 US 308, 315** "But the tax law deals in economic realities, not legal abstractions, * * *". That this

Court has remained ever mindful of those two great overriding and guiding tenets of tax law, to which many others should be deemed ancillary and subservient, and continues to apply them is clearly demonstrated in later cases. For instance, in **Washington v U.S. 460 US 557** they served as the only real justification of the Court's decision, without which one must conclude that the strong dissenting opinion of four of the Justices surely would have provided the basis of a unanimous decision of the Court, affirming rather than reversing the Court of Appeals. Although there a special sales tax on Federal contractors was at least facially suspect, it was thought by the Court's majority not to discriminate operationally against building contractors dealing with the Federal government, because for them the tax base was found to be less than for nonfederal contractors; but it should be

noted that was disputed, as a matter of fact, in the dissenting opinion, at lc 554. In the instant case that factual issue problem does not arise, as all the relevant and material facts are agreed to and undisputed (App. 23-33). Since here the discrimination is undisputed, utter and substantial, the Court can prevent the obvious and flagrant abuse without having to "dissect and carefully measure" Missouri's income tax system, in its taxation of Social Security benefits.

In **Washington supra,** and in many other cases, including **Davis supra,** this Court has declared that a State is prohibited by the immunity doctrine from imposing a discriminatory tax on the Federal government or those with whom it deals, including such persons as building contractors and Federal lessees and others voluntarily dealing with the Federal government. Here it is believed that

recipients of Social Security retirement benefits are persons who deal with the Federal government, by having involuntarily paid Social Security taxes and participated in the retirement program that was established and is administered by the Federal government. It has a very substantial interest in making sure that the benefits are not diminished by discriminatory state taxes thereon, which could frustrate pro tanto the Federal government's purpose to avoid a need to make compensating increases in the benefits scale and resultant need to increase the Social Security or other tax rates. Any such tax increase would weigh heavily on the already overburdened great body of taxpayers in the lower and intermediate income categories.

The opinion below (App. 5) plucked from **Exxon Corporation 462 US 176, 195** the catch phrase "lenient standard of

rationality" as if that alone was enough to dispose of the equal protection issue, without bothering to see that the facts of that case leave it inapposite here, as do those of every other case in which this Court has used that phrase, and without considering the meaning of "rationality" which is reasonableness, and all the while ignoring the suspect classification and fundamental rights that are here involved. The Court below failed to notice the distinguishing facts in **Exxon** which were that the state there had a legitimate purpose of protecting consumers from excessive prices and of encouraging investment in oil and gas production, which could be deemed to directly promote the general welfare. In the case at hand there is perceived no such purpose, but only an indefensible discrimination unsupported by any reasonable classification.

The Court below in its opinion (App.

5) relies on its earlier opinion in **Schnorbus** that found it rational for the General Assembly to exempt public employee retirement benefits as a means of creating "an additional benefit for potential employees to be attracted to government service in Missouri." That is pure sophistry, because without that invidious discrimination the government legitimately could accomplish its purpose simply by establishing and maintaining a scale of compensation commensurate with the value of services of the competent persons sought to be enlisted in government service, thereby obviating any occasion for special and indefensibly discriminatory exemptions. In **Davis 489 US at 816** this Court in disposing of the State's attempt to justify the preferential treatment of its retired employees by means of that tax exemption inducement, said:

This argument is wholly

> beside the point, however, for it does nothing to demonstrate that there are "significant differences between the two classes" themselves; rather, it merely demonstrates that the State has a rational reason for discriminating between two similar groups of retirees. The State's interest in adopting the discriminatory tax, no matter how substantial, is simply irrevelant to an inquiry into the nature of the two classes receiving inconsistent treatment.

Interestingly, in that case Michigan law, while completely exempting public retirement system benefits, also exempted with some measure of generosity the first $7,500.00 for a single return and the first $10,000 for a joint return of retirement benefits "from any other retirement system" which by reasonable construction included Social Security retirement benefits. In contrast, Missouri's discrimination is far more egregious, in allowing no exclusion whatever for any "other" retirement system benefits (for year 1987).

As a matter of practicality and

economic reality, logic and fairness, there is no justification for the disparate tax treatment in this case of various types of workers. The only real and significant differences between retired government employees on the one hand and retired private sector workers on the other are that the former, almost without exception, are able to retire much earlier in life while the latter continue being taxed on earned income, supporting themselves by working harder and are obliged to wait until much later in life to start receiving retirement benefits. All those would be excellent reasons for according preferential treatment to private sector retirees, not to governmental retirees. At least it can be said that equal treatment of the two groups would be more consistent with the concept of government of, by and for the people.

Returning to **Schnorbus (790 SW2d at 243)** the Court noted, presumably relying on it in part at least to justify its decision, that the cost to the State of exempting private pensions would be over $68 Million per year. But that does not justify an unconstitutional tax exaction. Also, in **Schnorbus** the Court was not called upon to consider the discrimination issue that here is shown to result from exemption of railroad retirement benefits.

If it be considered there are "significant differences" between governmental and nongovernmental retirees, which Petitioners dispute, that still leaves unanswered the question regarding the inconsistent treatment of the two practically identical private sector groups, one receiving retirements under the Social Security Act and the other under the Railroad Retirement Act. There is no way a disparate classification and unequal

treatment of those two types of retirement benefits can be justified. They are essentially alike. Both are provided by retirement systems for workers in the private sector, established by and administered pursuant to Federal laws, and so closely related that as a matter of practicality and economic reality and from a political and societal standpoint they can be viewed as but two parts of a single system. Both are funded by taxes on employers and employees, at the same rates and subject to the same wage base limitations; and the amounts of Railroad Retirement age or disability benefits, and any increases and reductions therein, are, by 45 USC §231b, made equal to those provided in the Social Security Act.

B

Taxation by Missouri of Social Security benefits is prohibited by Social Security Act §207 (42 USC §407) coupled

with the supremacy clause of Art. VI of the US Const. Both are set forth at page 4 hereof. That statute prohibits, among other things, "levy", meaning tax, on such benefits. The work "levy" has two main meanings (1) imposition of a tax and (2) actual or symbolic seizure of property as a part of legal process. The first meaning is used in Mo. Const. Art. X, §3: "Taxes may be levied and collected for public purposes only * * *". This Court, and others, also legislative bodies repeatedly have used the words "levy" and "tax" synonymously and interchangeably. For instance, in **Aloha Airlines, Inc. v Director of Taxation of Hawaii, 464 US 7, at 13-14** it was said:

> The manner in which the state legislature has described and categorized §239-6 cannot mask the fact that the purpose and effect of the provision are to impose a levy upon the gross receipts of airlines * * *. A state statute that imposes such a tax is therefore preempted.

Applicable here are two correlate rules of construction, that a legislature is presumed to use no superfluous words and that significance and effect should be accorded every word. **Platt v Union P.R. Co. 99 US 48, Boone County Court v State 631 S.W.2d 321, 325,** where the Court, referring to "activity or service" as used in a constitutional provision, said:

> If these terms were intended to have the same meaning the use of only one of them would be necessary, and the other would be surplusage; included for no reason. Such a construction is not favored.

Application of those rules leads to the following conclusions. To attribute to "levy" as used in 42 USC §407 its second meaning only "seizure of property" would violate the rule against tautology, because the other words in that section "execution * * * attachment, garnishment or other legal process," are utterly comprehensive and adequate to signify the application of

debtor's property to satisfaction of a creditor's claim, without any help from "levy", which would be but a part of that "legal process". That leaves for attribution to "levy" only the first meaning, imposition of a tax, in accordance with the second rule that meaning must be accorded every word used in the statute. Of course, if levy were given both its main meanings, that also would preclude the imposition of a tax. A case in which a word was given its full meaning is **Ash Sheep Co. v US 252 US 159**, in which the question was whether "cattle" used in a statute treating of Indian land included sheep. While noting it ordinarily did not, this Court decided that as used in the statute, even though it was one to be strictly construed, it did, and said, l.c. 170:

> The admitted rule that penal statutes are to be strictly construed is not violated by

> allowing their words to have full meaning * * *.

In 42 USC §407 "levy" is included in a disjunctive series of words, and so should be accorded its independent and full meaning. In **Reiter v Sonotone Corp. 442 US 330, 338-339,** this Court, in construing 15 USC §15, said that to ignore "or" would rob each word so connected of "its independent and ordinary significance".

In the **Platt case, supra** it was held also that a statute should be construed to effectuate the object which Congress had primarily in view. The obvious object of 42 USC §407 was to erect around Social Security benefits an impenetrable bulwark of protection against all manner of deprivation or diminution. **SEC v Nat'l Securities 393 US 453** involved antifraud provisions of the Securities Laws and the question whether in a merger transaction the exchange of stock for stock occurred "in connection with the purchase or sale of

any security". This Court held that it did and, l.c. 466, after observing that the words "purchase or sale" must be construed in the context of the statute, and with the comment that whatever they may mean in other contexts, said:

> The broad antifraud purposes of the statute and the rule would clearly be furthered by their application to this type of situation.

In other words, what is far more important than the literal word or syntactical context is the context of underlying purpose and aim of the statute being construed. That was affirmed in **Davis v Michigan 489 US at 809** where this Court said:

> Although the State's hypertechnical reading of the nondiscrimination clause is not inconsistent with the language of that provision examined in isolation, statutory language cannot be construed in a vacuum. It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view

to their place in the overall statutory scheme.

Apart from all the conventional canons of statutory construction, there is a unique feature of another statute that provides clear insight to Congressional intent and understanding that "levy" as used in §207 of the Social Security Act (42 U.S.C. §407) means tax. IRC §86 (26 U.S.C. §86) is a tax statute. Congress, when enacting it in 1983, realized that §86 in levying a tax on Social Security benefits needed to comply with subsection (b) of §207, so it included in §86 the phrase "notwithstanding §207 of the Social Security Act" - because without that reference §86 might be rendered ineffectual as to Social Security benefits and be construed to tax Tier 1 Railroad Retirement benefits only. Obviously, if §86 did not "levy" a tax on Social Security benefits, it would not operate to "limit, supersede or otherwise modify" §207, and the

reference thereto in §86 would be unnecessary, and irreconcilable to the presumption against superfluity.

There is an additional cogent and conclusive reason, sufficient in itself, for holding Social Security Act §207 prohibits state taxation of Social Security benefits, and that is to make it consistent with 45 U.S.C. §231m (set forth at page 4 hereof) which clearly and indisputably prohibits state taxation of Railroad Retirement benefits. Absent that consistency, there would be, for state income tax purposes, a constitutionally prohibited discrimination against recipients of Social Security benefits, in favor of recipients of Railroad Retirement benefits, for reasons hereinbefore pointed out. This calls for application of the rule that if a statute appears to be susceptible to two different interpretations one of which makes it constitutional and the other not, the Court

will adopt the latter.

The Court below, referring to 45 U.S.C. §231m (App. 8) said:

> The Federal prohibition against taxing "Tier 1" benefits provides all the rational basis necessary to support the State's exemption of "Tier 1" benefits while taxing Social Security benefits.

What is extremely significant, but was overlooked by the Court, is that Congress in IRC §86, for Federal income tax purposes does not discriminate in favor of Tier 1 benefits and against Social Security benefits, but treats both in precisely the same way in §86(d)(1). Is it reasonable to assume Congress intended the states were free to do otherwise? Certainly not!

By its statement above the Court below infers that the State's discrimination, however egregious, was the Federal government's doing, over which the State had no control and for which it has no responsibility but of which it is at liberty to take advantage. The answer to

that erroneous notion would be that an unreasonable discrimination, however and by whomever instituted, and whether deliberate or accidental, is unconstitutional. The Federal Government has not, as the Court below claims, permitted Missouri to discriminate. Had the Federal Government done that, it would have been in violation of the equal protection component of the Fifth Amend. of the U. S. Const.

The Court below (App. 10) cited and agreed with **Boersma v Karnes 417 N.W.2d 341 (Neb.)** in holding "levy" in 42 U.S.C. §407 does not prohibit a tax on Social Security benefits. Except for that, **Boersma** did not involve any of the issues here presented, and it is apparent that, in construing that statute, neither the Nebraska Court nor the Court below considered any of the controlling decisions of this Court on statutory construction hereinbefore

mentioned. If those were not brought to this Court's attention, that may, in part at least, explain dismissal of appeal in **Boersma 48 US 801** "Justices White and Blackmun would note probable jurisdiction and set the case for oral argument". However that may be, a second look is justified.

It would be but a very short and logical step from this Court's decisions in **Philpott v Essex County Welfare Board 409 US 413** and **Bennett v Arkansas 485 US 395**, and quite consistent with the broad underlying aim of 42 USC §407 in providing a shield against creditors, to hold that it prohibits state taxation of Social Security benefits, because a State in taxing those benefits becomes in a very real, practical and preferred sense a creditor of the recipient of the benefits at the moment of assessment of the levy; and it is only reasonable to consider that a State in sc

doing, as a matter of practicality and economic reality, is depriving the recipient of and diminishing his or her benefits in the proportion of the recipient's total tax that the part of the benefits taxed bears to the recipient's total taxable income.

§207(a) of the Social Security Act was enacted originally as §208 of Act Aug. 14, 1935, was redesignated §207(a) in 1939, and its wording then was the same as now. At those earlier times it probably did not occur to Congress, or anybody else, that Social Security benefits would ever be taxed. Of course, in 1983 when subsection (b) was added, and IRC §86 was enacted, §207(a) could have been made more explicit in prohibiting such taxation, but perhaps Congress simply did not think about it, or considered that was already accomplished by "levy" meaning tax. In **Davis v Michigan, 489 US at 810**, this Court observed that

Congress could perhaps have used more precise language, but readily construed the statute there involved consistently with its clearly reflected purpose.

C.

IRC §86 (26 USC §86) operated in this case, as a matter of practicality and economic reality, as a tax on Petitioners' tax-exempt interest, to the extent hereinafter indicated.

It is undisputed, indeed it is agreed and stipulated (App. 24, 25) and explained at Page 10 hereof, that a part of Petitioners' Social Security benefits was taxed solely as a result of their complying with the requirement of IRC §86(b)(2)(B) that tax-exempt interest be included in arriving at "modified adjusted gross income". To that extent, the tax actually was not, as it purported to be, a tax on Social Security benefits, but was a tax on tax-exempt interest, and as such violated

the intergovernmental tax immunity doctrine, the equal protection component of the due process clause of the Fifth Amendment and, with respect to the Missouri tax, the equal protection clause of the Fourteenth Amendment, of the U.S. Const., because it so taxed Petitioners' tax-exempt interest while taxpayers without Social Security benefits, including many whose federal taxable income for year 1987 exceeded that of Petitioners, were accorded the full, unlimited and undiminished benefit of the IRC §103 exemption (App. 29). That was unreasonable, unjustified and impermissible discrimination against Petitioners, for reasons made clear in decisions of this Court herein mentioned.

If a tax is ostensibly laid on one subject, but is to be measured by another, in substance and effect it is the latter that is being taxed. In **Miller v Milwaukee 272 US 713, 715** Justice Holmes declared:

> If the * * * self-evident operation of a statute is to follow the bonds of the United States and to make up for its inability to reach them directly by indirectly achieving the same result, the statute must fail even if but for its * * * special operation it would be perfectly good.

In **Macallen Co. v Mass. 279 US 620, 629** it was stated:

> These constitute special and compelling reasons why courts, in scrutinizing taxing acts like that here involved, should be acute to distinguish between exaction which in substance and reality is what it pretends to be, and a scheme to lay a tax upon a nontaxable subject by a deceptive use of words.

Three Justices joined in a dissenting opinion that appears to have been based on a perceived de minimis tax burden, practicality and the nondiscriminatory character of the tax there involved, which treated alike federal, state and municipal bonds. That dissenting opinion may be thought later to have taken effect in **Lenhauser v Lakeshore Autoparts Co. 410 US**

356; but this Court has not rejected or questioned the wisdom and verity of the above quotation from **Macallen**.

The principle applied in those cases was codified and is reflected in 31 USC §3124, which reads in part:

> Stocks and obligations of the United States Government are exempt from taxation by a state or political subdivision of a state. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation or both, to be considered in computing a tax * * *

That statute has an interesting history, referred to in **American Bank and Trust Co. v Dallas County, 463 US 855, 865-866**, where it was noted the catalyst for the 1959 amendment of that statute was an Idaho tax and that State's contention it was merely "measured by" net income that included interest received on federal obligations, which the Secretary of the Treasury characterized as resting upon a distinction of words that is without substance. By

enactment of 31 USC §3124 the Federal Government has acknowledged the principle of construction that should be applicable to any tax statute, either state or federal, by which the true character of the tax it levies is determined according to the practical effect of the formula prescribed for its computation, and not by an arbitrary, obfuscating or irreconcilable label the enactors have contrived to put on it.

In its opinion (App. 15) the Court below said:

> The Carters also charge that the statute violates equal protection because it discriminates between taxpayers on Social Security with tax-exempt interest and those without tax-exempt interest.

That statement, because of the last five words thereof, is unintelligible. Petitioners made no such assertion. Presumably the Court, in referring to IRC §86, was trying to paraphrase Petitioners'

contention that is reflected in No. 3 of the questions presented (first page inside cover hereof) together with the discrimination that was stipulated in paragraph 6 of the record (App. 29). The Court's statement would have made sense had its concluding reference been to those without Social Security retirement benefits but with tax-exempt interest and with taxable income exceeding that of Petitioners. Petitioners are unwilling to leave unchallenged the Court's imputation to them of that inept statement.

Comments of the Court below (App. 14, 15) on **South Carolina v Baker, 485 US 505**, show it misunderstood and has misapplied that case. What eluded the Court below was the significance of repeated references in that case, particularly at l.c. 523-524, to a "nondiscriminatory" tax, which make it favorable to Petitioners here. Essentially, what this Court did in that

case was to uphold §310(b)(1) of TEFRA, which added 26 USC §103(j)(1) and which removed (with specified exceptions) the federal tax exemption for interest on certain bonds issued by state and local governments unless those bonds are registered. As was pointed out, 485 US at 509, the statute was justified to help prevent tax evasion (an admirable purpose). This Court, referring to §310, noted, at 510, " * * * it covers not only state bonds but also bonds issued by the United States and private corporations". Thus, it provided nondiscriminatory treatment, which is something IRS §86(b)(2)(B) in its operation denies Petitioners.

In its opinion (App. 16) the Court below cited and relied on **Goldin v Baker, 809 F 2d 187 (2nd Cir. 1987).**

In that case IRC §86 was challenged by New York City, not as here by individual taxpayers; and there the City did not

invoke, as do Petitioners here, the equal protection clause or component of the Fourteenth and Fifth Amendments, or benefit of the intergovernmental tax immunity doctrine, as accorded those with whom the Federal Government deals in respect of the Missouri tax, and those with whom the State deals in respect of the discriminatory tax imposed on individual taxpayers by IRC §86(b)(2)(B).

Moreover, **Goldin** strongly relied on **US v Atlas Life Ins. Co. 381 US 233**, which, when analyzed and correctly applied, supports Petitioners here. What this Court did in **Atlas** was fully to allow, but uphold the tax Act's requirement of a fair allocation of, the tax-exempt interest benefit, on an investment income basis, in part to policyholders' reserve and in remainder to the insurance company itself. Such allocation served only to deny the insurance company an excessive and

unintended benefit, by application of the same principles of fairness and reasonableness that underlie 26 USC §265(a)(2), which denies reduction of "interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from the taxes imposed by this title". Petitioners here are not seeking any excessive benefit, but only the same benefit in the same full measure that 26 USC §103 allows taxpayers in general with income however great but not including any Social Security benefits, or including some Social Security benefits as well as some tax-exempt interest, but with sufficient other income to subject the maximum one-half portion of the Social Security benefits to the income tax without having to take into consideration any of the tax-exempt interest.

Vol. 70, No. 45 Tax Focus/Oct. 5, 1983, a special feature of **CCH Standard Federal Tax Reports**, contains some highly informative and extremely interesting comments on **IRC §86**. Set forth in the App. are some relevant parts of that **Tax Focus** (App. 33 et seq) including a reference to S. 1113 (which was raised on the Senate Floor as an amendment to an omnibus tax bill, H.R. 4170) which the Senate, presumably realizing the tax-exempt interest feature of §86 was unconstitutional, passed by a vote of 63 to 32; but when it went to the Joint House-Senate Conference Committee it was dropped.

As the **Tax Focus** goes on the point out, §86 is a weird and wonderful work in other ways as well. Bad as all there shown is, it still has not taken into account the unconstitutional tax on tax-exempt interest and the illegal State income taxes on Social Security benefits.

If this Court finds subsection (b)(2)(B) unconstitutional, the remainder of §86 may remain unaffected, under the separability clause of IRC §7852(a). However, and although not an issue in this case, §86 may be further flawed by its failure in some situations properly to allow recovery of cost represented by FICA Employee and Self-Employment Taxes paid. Such allowance should be made to avoid confiscatory exaction. That, it is believed, will become a progressively greater problem, as more and more cases arise in which benefits will be substantially taxed, and terminated by death, before complete recovery of cost will be achieved.

Undoubtedly the Federal Government has the power to tax Social Security retirement benefits, and, if so disposed, permit States to do so. That could be done in a

simple and forthright manner by making all the benefits includible in gross income, after allowing recovery of cost or basis, then letting a taxpayer's properly taxable portion of the benefits together with all of his other taxable income be taxed according to the applicable graduated tax rates and personal and dependents exemptions. But to do it right, Congress apparently needs some help from the judiciary.

CONCLUSION

This is an ideal case for review, because it does not present any issue of fact but only substantial Federal questions this Court should decide for the sake of many thousands of interested taxpayers who cannot afford to engage in tax litigation, and for the Petitioners who are doing it nevertheless.

Respectfully submitted,

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APPENDIX

SUPREME COURT OF MISSOURI

en banc

GILBERT AND VIRGINIA CARTER,	)	
	)	
Appellants,	)	
	)	
v.	)	**No. 73049**
	)	
DIRECTOR OF REVENUE, STATE OF MISSOURI,	)	
	)	
Respondent.	)	

PETITION FOR REVIEW OF A DECISION OF THE ADMINISTRATIVE HEARING COMMISSION
Honorable Paul M. Spinden, Commissioner

Appellants Gilbert and Virginia Carter challenge Missouri's authority to tax portions of their Social Security retirement benefits,claiming that such income taxation violates: (1) equal protection, U.S. Const. amend XIV and Mo. Const. art. I, sec. 2; (2) the Social Security Act, 42 U.S.C. sec. 407; (3) intergovernmental tax immunity, U. S. Const. amend X; (4) Mo. Const. art. X, sec. 18(a) (establishing a revenue ceiling for state revenues); and (5) Mo. Const. art. III, sec. 1 (vesting legislative power in

the Missouri General Assembly). The Administrative Hearing Commission (the Commission) denied the Carters' claims; they appealed. Because this case involves the construction of the revenue laws of this state, this Court has exclusive appellate jurisdiction. Mo. Const. art. V, sec. 3 and 18; Section 621.189, RSMo 1986. Affirmed.

I.

The parties agree on the facts. The Carters filed a combined Missouri form 40 tax return for 1987. Appellants sought to exclude from their Missouri taxable income $8,748 received in federal Social Security benefits. The Carters included these benefits in their adjusted gross income for federal income tax purposes. The Department of Revenue denied the exclusion. The Carters sought review in the Commission. The Commission sustained the Director's denial of the Carters' claim for refund. This petition for review followed.

II.

A.

For their first point, the Carters argue that Missouri's taxation of Social Security benefits together with this State's exemption of certain Missouri retirement benefits[1] from state taxation violates the equal protection guarantees of U.S. Const. Amend XIV and Mo. Const. art. I, sec. 2. In support of this point, the Carters contend that **Davis v. Michigan Department of Treasury, 489 U.S. 803 (1989)**, and **Hackman v. Director of Revenue, 771 S.W.2d 77 (Mo. banc 1989)**, control the result in this case.

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[1] **See, e.g.**, Section 70.755, RSMo 1986 (officers and employees of political subdivisions); Section 86.190, 86.353, 86.493, and 87.365, RSMo 1986 (police and fire pensions); Section 104.250, RSMo 1986 (employees of the State Highway Patrol and Department of Highways and Transportation); Section 104.540, RSMo 1986 (elected state officials and state merit system employees); Section 169.587, RSMo 1986 (teachers and school employees).

Read together, **Davis** and **Hackman** hold that a state law permitting taxation of federal retirement benefits while exempting state retirement benefits violates the intergovernmental tax immunity commanded in 4 U.S.C. sec. 111.[2]

Neither **Davis** nor **Hackman** assist the Carters. Those cases rest on principles of intergovernmental tax immunity mandated by federal statute. Since neither **Davis** nor **Hackman** rests on equal protection grounds, those cases are of no assistance to the Carters' equal protection claim.

Where neither a suspect classification nor a fundamental right is involved, a

---

[2] 4 U.S.C. Sec. 111 provides:

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States . . . by a constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

classification is measured against "the lenient standard of rationality" applied to economic and commercial regulation for purposes of equal protection analysis. **Exxon Corp. v. Eagerton, 462 U.S. 176, 195 (1983).** If any state of facts can be conceived to justify a classification, it will be sustained. **City of St. Louis v. Liberman, 547 S.W.2d 452, 458 (Mo. banc 1977).**

In **Schnorbus v. Director of Revenue, 790 S.W.2d 241, 243 (Mo. banc), cert. denied, ___ U.S. ___ (1990),** this Court found it rational for the General Assembly to exempt public employee retirement benefits as a means of creating "an additional benefit for potential employees to be attracted to government service in Missouri." This rationale, applicable to the public retirement benefits in this case, is sufficient to repel the Carters' equal

protection attack. The point is denied.

B.

The Carters' next point arises from differing treatment by the United States Congress of Social Security benefits and "Tier I" railroad retirement benefits. While federal law does not prohibit state taxation of Social Security benefits, 45 U.S.C. sec. 231m does exclude certain "Tier I" railroad retirement benefits from state taxation. The Carters contend that any attempt by Missouri to tax Social Security benefits while exempting from taxation "Tier I" railroad retirement benefits violates the equal protection guarantees of the federal and state constitutions by treating two classes of pensions differently for state income tax purposes.

The authority of the federal Congress to prohibit state taxation of categories of income is clear. U.S. Const. art. VI, sec.

2. The Carters do not contend otherwise. Instead, their argument goes to the power of Missouri to tax Social Security benefits in the absence of express authority to do so, and in the face of the mandate of Congress that similar pension benefits-the "Tier I" benefits-are exempt from state tax. Appellants expressly eschew a challenge to 45 U.S.C. sec. 231m; instead, they attack Missouri's differing treatment of the two categories of income.

We retreat to **McCullough v. Maryland, 17 U.S. 415, 432 (1819)**, for guidance here. There, the United States Supreme Court noted that the power of taxation "is retained by the States; that it is not abridged by the grant of a similar power to the government of the Union; that it is to be concurrently exercised by the two governments." Thus, the federal Constitution permits the states to maximize income tax revenues so long as

its tax levies do not run afoul of federal prohibitions. Thus, taxation of Social Security benefits by Missouri is permissible because it is not prohibited by federal law.

The Carters' equal protection argument on this point must also fail. It is not the state law that establishes the classifications challenged; it is federal law. The Carter's argument bypasses the constitutionality of 45 U.S.C. 231m, instead challenging the state's discrimination on the basis of that law. They charge that Missouri can have no rational basis for taxing Social Security benefits while exempting "Tier I" benefits. The state, however, needs no rational basis to tax; only to discriminate. The federal prohibition against taxing "Tier I" benefits provides all the rational basis necessary to support the state's exemption of "Tier I" benefits while taxing Social Security benefits.

C.

For their third point, the Carters argue that taxing Social Security benefits violates Section 207 of the Social Security Act (42 U.S.C. sec. 407). Section 207 reads:

> (a) The right of any person to any future payment under this title shall not be transferable or assignable at law or in equity, and none of the moneys paid or payable or rights existing under this title shall be **subject to execution, levy, attachment, garnishment or other legal process,** or to the operation of any bankruptcy or insolvency law.
>
> (b) No other provision of law, enacted before, on, or after the date of the enactment of this section, may be construed to limit, supersede, or otherwise modify the provisions of this section except to the extent that it does so by express reference to this section.

[Emphasis added.]

The Carters contend that the word "levy" means the "imposition of a tax." Thus, they posit, the phrase "**subject to**

execution, levy, attachment, garnishment or other legal process" prohibits Missouri from taxing Social Security benefits.

We disagree. The word "levy" should be read within the context of the statute in which it is found to determine its meaning. "The words surrounding 'levy' in [sec. 207] operate to protect the Social Security benefits . . . . Judgment creditors . . . may not use the proceeds of the Social Security system to satisfy private obligations." **Boersma v. Karnes, 417 N.W.2d 341, 347 (Neb.), appeal dismissed by, 488 U.S. 801 (1988); accord Matter of Neavear, 674 F.2d 1201, 1206 (7th Cir. 1982).** We agree with **Boersma** and do not believe that the word "levy" in 42 U.S.C. sec. 407(a) applies to the imposition of a tax. We hold, therefore, that the prohibition in 42 U.S.C. sec. 407(a) does not apply to Missouri's

authority to tax Social Security benefits.

D.

Next, the Carters directly challenge the validity of 26 U.S.C. sec. 86(b) which includes tax-exempt interest in the calculation of appellants' taxable Social Security benefits. Section 86(a) defines "gross income for the taxable year" to include the lesser of "one-half of the social security benefits received during the taxable year" or "one-half of the excess described in subsection (b)(1). Section 86(b)(1)(A) requires the taxpayer to include "modified adjusted gross income" in the calculation to determine whether a tax is due. Section 86(b)(2)(A) defines "modified adjusted gross income" to include "interest received or accrued by the taxpayer during the taxable year which is exempt from tax."

The inclusion of tax-exempt interest

required by section 86 in determining the threshold for taxation of Social Security benefits caused the Carters to incur income tax on an additional income of $5,907. In effect, the Carters argue, federal law permits the taxation of tax-exempt interest, thereby violating the doctrine of intergovernmental immunity as well as equal protection.

1.

The Director initially questions this Court's authority to rule on the validity of a federal statute. Under Mo. Const. art. V, sec. 3, however, this Court has "exclusive appellate jurisdiction in all cases involving the validity of a treaty or statute of the United States." **Swift & Co. v. Doe, 311 S.W.2d 15, 22 (Mo.), transferred to 315 S.W.2d 465 (Mo. App. 1958), cert. denied, 359 U.S. 911, cert. denied sub nom. Missouri Pacific Ry. Co. v. Doe, 359 U.S. 915 (1959).** See also 28

U.S.C. 1257 (1988) (authorizing review by United States Supreme Court of any state high court decision questioning the validity of the federal statute.) On the strength of this authority, we believe we may consider the Carters' attack on the federal statute.

2.

On the issue of intergovernmental immunity, appellant asserts that 26 U.S.C. sec. 86 allows an impermissible interference with other governmental units, i.e., those issuing tax exempt securities. The argument appears to be that section 86 permits a tax on tax exempt securities issued by state and local governments.

In **Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895)**, the Supreme Court relied on the Tenth Amendment to apply the doctrine of intergovernmental immunity to attempts by the federal government to tax the states. That case prohibited the

federal government from imposing a tax on income derived from municipal bonds. The Court reasoned that such a tax was a tax on the government because the tax burden might be passed on to that government through the bond contract; that is, the state government might face a higher borrowing rate as a result of the tax on the bondholders' income.

South Carolina v. Baker, 485 U.S. 505, 524 (1988), however, noted "the historical fact that Congress has always exempted state bond interest from taxation **by statute."** [Emphasis added.] **Id.** at 523. Expressly overruling **Pollock, Baker** found no constitutional basis for applying the doctrine of intergovernmental tax immunity to an indirect tax on a state, that is, a tax on the income received by persons holding state bonds.

There being only a statutory basis for indirect intergovernmental tax immunity, it

follows that Congress retains the power to determine the breadth of that immunity by statute. Here, Congress has determined that interest earned by taxpayers from otherwise tax exempt sources must be included in the formula to determine the level of taxation of Social Security benefits. No constitutional violation is present in that determination.

3.

The Carters also charge that the statute violates equal protection because it discriminates between taxpayers on Social Security with tax-exempt interest and those without tax-exempt interest. Again, the Carters cannot here claim discrimination founded on a suspect classification or that infringes a fundamental right. There, the test even for the Congress is the "lenient standard of rationality" described in **Exxon Corp. v. Eagerton**, 462 U.S. 176, 195 (1983).

Section 86 intends "to strengthen the Social Security system by requiring 'taxpayers who have a comfortable flow of income' to pay a tax on part of their social security benefits." **Goldin v. Baker,** 809 F.2d 187, 190 (2nd Cir. 1987), **quoting** S.Rep. No. 23, 98th Cong., 1st Sess. 25-28, reprinted in 1983 U. S. Code Cong. & Ad. News 143, 166-69. This congressional purpose is rational and is sufficient to defeat the Carters' claim.

E.

Next, the Carters claim that state taxation of Social Security benefits violates the "spirit & purpose" of Mo. Const. art. X, sec. 18. That constitutional provision establishes a limit on "the total amount of taxes which may be imposed by the general assembly in any fiscal year on the taxpayers of this state."

The Carters' brief states that the taxation of Social Security benefits "broadened the income tax base without voter approval." The Missouri Constitution does not require voter approval when the General Assembly broadens the tax base. Art. X, sec. 18, is violated only when total state revenues exceed the revenue limit established in that section. There is no evidence in this record to support the Carters' claim. The point is denied.

F.

The Carters' final point urges that the pegging of Missouri taxpayers' adjusted gross income to the taxpayers' federal adjusted gross income is an unconstitutional delegation of legislative power, citing Mo. Const. art. III, sec. 1.[3]

---

[3] Art. III, sec. 1, provides: "The legislative power shall be vested in a senate and house of representatives to be styled "The General Assembly of the State of Missouri."

The Carters argue that the legislature cannot simply "sit back" and permit changes by a U.S. Congress not the least bit concerned with Missouri income tax laws."

We disagree. Mo. Const. art. X., sec. 4(d), expressly permits incorporation of federal law for purposes of Missouri income taxation. "In enacting any law imposing a tax on or measured by income, the general assembly may define income by reference to provisions of the laws of the United States."

Undaunted, the Carters suggest that the adoption of art. X, sec. 18, rendered art. X., sec. 4(d), inoperative. This contention is apparently based on the ballot notice to the broad tax and spending limitation initiative which presented art. X, sec. 18, and other proposed constitutional amendments to the voters for inclusion in the constitution. Without

explanation, that notice cited a conflict between the provisions of the art. X, sec. 4(d) and the so-called Hancock Amendment. **Boone County Court v. State,** 631 S.W.2d 321, 328 (Mo. banc 1982) (Bardgett, J., dissenting).

The legal significance of the notice as to the conflict the Carters contend exists in this case escapes us. They present no argument beyond the bare assertion that art. X, sec. 18, prohibits "automatic, accidental changes, for Missouri income tax purposes." As we have previously stated in this opinion, art. X, sec. 18, is offended only to the extent that total state revenues exceeds the revenue limit imposed by art. X, sec. 18(a). The Carters have made no such showing on this record. The point is denied.

III.

The decision of the Administrative

Hearing Commission is affirmed.

EDWARD D. ROBERTSON, JR., Judge

All concur.

DATE OPINION ENTERED

The foregoing opinion, including order affirming the decision of the Administrative Hearing Commission, was filed and entered on March 5, 1991.

MOTION FOR REHEARING AND ORDER OVERRULING

On March 18, 1991 Appellants filed in the Missouri Supreme Court, pursuant to and within the period of fifteen days allowed in its Rule 84.17, their motion for rehearing. In disposing thereof that Court on April 9, 1991 made and entered the following order: "Appellants' motion for rehearing overruled."

Before the

Administrative Hearing Commission

State of Missouri

Gilbert and Virginia Carter, Petitioners,	)	
vs.	)	Case No. 90-000614RI
DIRECTOR OF REVENUE, Respondent.	)	

MEMORANDUM DECISION

On May 4, 1990, Gilbert and Virginia Carter filed their complaint seeking this Commission's determination that the Director of Revenue had erroneously denied their request for refund of income taxes by his final decision dated April 24, 1990. On July 30, 1990, the parties jointly waived a hearing and written findings of fact and conclusions of law and requested that this Commission issue a memorandum decision as provided for in §536.068.2, RSMo Supp. 1989.

Because of the record's paucity, we base our decision upon the facts admitted by the Director in his answer. The Carters sought a refund of $518.60 for tax year

1987. They contended that they were not obligated to include all of their Social Security benefits in their Missouri taxable income. The Director denied the refund claim because Missouri taxable income is federal adjusted gross income modified as provided for in Chapter 143, RSMo, and that chapter contains no provision permitting the modification sought by the Carters.

The Carters advance five arguments, all constitutional in nature. On various grounds, relating to either the federal or the Missouri constitutions, the Carters urge us to set aside portions of the United States Internal Revenue Code and Chapter 143, RSMo. This Commission does not have authority to set aside any portion of either the Internal Revenue Code or Chapter 143, RSMo. Only the judiciary can set aside a statute on grounds of unconstitutionality. City of Joplin v. Industrial Commission of Missouri,

329S.W.2d 687 (Mo. banc 1959); State Tax Commission v. Administrative Hearing Commission, 641 S.W.2d 69 (Mo. banc 1982). Therefore, we uphold the Director's denial of the Carters' refund claim.

SUMMARY

The Commission determines that the Carters' have failed to show that the final decision of the Director of Revenue was erroneous.

SO ENTERED this 16 day of August, 1990.

/s/ Paul Spinden

PAUL M. SPINDEN
Commissioner

IN THE SUPREME COURT OF MISSOURI

GILBERT and VIRGINIA CARTER, Appellants,	)	
v.	)	**No. 73049**
DIRECTOR OF REVENUE STATE OF MISSOURI, Respondenct.	)	

ABBREVIATED/PARTIAL RECORD ON APPEAL

Pursuant to Rule 100.02(e)(2) and the

concluding clause of Rule 81.12(a), the parties agree as follows:

1. The material facts are undisputed and the two main issues of law are: (1) whether, for Missouri income tax purposes, Appellants are entitled to exclude from their 1987 Missouri adjusted gross income $8,748, representing the portions (husband $5,948, wife $2,800) of their social security retirement benefits they included in their federal adjusted gross income for that year in compliance with Internal Revenue Code §86 (26 U.S.C. §86); (2) in the alternative, if they were not entitled to so exclude that $8,748 portion, whether they properly could have included in both federal and Missouri adjusted gross income only $2,841 representing the portions (husband $1,932, wife $909) of such benefits that would have been included in federal adjusted gross income as called for in IRC §86 had it not required adjusted gross income to be

increased by the amount of their tax-exempt interest in arriving at their "modified adjusted gross income". If Appellants are entitled to that $8,748 exclusion, they have overpaid their Missouri income tax for year 1987 by $518.60; if they are entitled to include in their Missouri adjusted gross income only $2,841 of those benefits, such overpayment is $354.60; and if there be an overpayment, it should be refunded with interest thereon from April 15, 1988 at a rate determined pursuant to §32.065, RSMo 1986, as provided in §143.811.1, RSMo 1986. If there was no overpayment, Appellants are not entitled to any recovery whatever.

2. Prior to, and as of April 15, 1988, Appellants filed with Respondent their Missouri Form 40 combined income tax return for 1987 in which, taking credit for $1,765 of estimated tax payments timely made, they showed a tax of $952 and an overpayment of

$813 and requested that $238 of the overpayment be applied on their estimated tax for year 1988 (which was done) and that the $575 balance be refunded to them. Attached to that return was a typewritten statement explaining that in arriving at their Missouri adjusted gross income, Appellants excluded $8,748 of their social security benefits that had been included in their federal adjusted gross income, and citing statutory and constitutional provisions thought to justify the exclusion. On audit, Respondent disallowed that exclusion, and arranged for a refund of $56.40 which was paid to Appellants by Missouri Treasurer's check dated May 18, 1988 and had the effect of reducing their claim to $518.60.

3. In April 1989, Appellants filed a claim for refund of the asserted overpayment, as adjusted to $518.60, which was denied on February 7, 1990. On March

14, 1990, Appellants filed with Respondent their protest against his denial of their claim which was denied on April 24, 1990. The refund claim and protest stated in substance that Missouri's imposition of an income tax on Appellants' social security benefits violated certain cited statutory and constitutional provisions, which essentially are those that were summarized in their petition for review of this case which subsequently was filed in this Court.

4. On May 4, 1990, Appellants filed with the Administrative Hearing Commission a complaint (Case No. 90-000614RI), that complied with Commission rules on form and content, and was accompanied by a copy of Respondent's denial of the protest and requested an order directing Respondent to pay the refund claim of $518.60 or, in the alternative, $354.60, with interest computed in the manner mentioned in paragraph 1, supra. The complaint contained allegations

of facts substantially like those detailed in paragraphs 2 and 3, supra. On June 7, 1990, Respondent filed his answer asking the Commission to sustain Respondent's final decision and grant other appropriate relief, which answer gave rise to the issues of law mentioned in paragraph 1, supra.

5. On July 30, 1990, the parties filed their Joint Motion for Memorandum Decision, pursuant to which the Commission entered its decision on August 16, 1990 which reads in part and concluded as follows:

> This Commission does not have authority to set aside any portion of either the Internal Revenue Code or Chapter 143, RSMo. Only the judiciary can set aside a statute on grounds of unconstitutionality. (Citations) Therefore, we uphold the Director's denial of the Carters' refund claim.

On August 30, 1990 Appellants filed in this Court their petition for its review of that decision.

6. For tax year 1987, there were many taxpayers, either single or married, each of whom had federal taxable income exceeding that of Appellants, and who received in that year interest on state and local bonds that was exempt under IRC §103 and was wholly excluded from their gross income for federal income tax purposes, and who did not receive in that year any social security benefits.

7. Appellants have requested Respondent to stipulate that for year 1987 and later tax years, Respondent has allowed, in arriving at Missouri adjusted gross income, exclusion of Tier I Railroad Retirement benefits that were included in federal adjusted gross income in compliance with IRC §86; but Respondent says he is unaware of his having done so, and has not ruled on or established any policy relating to such an exclusion, and he agrees that Appellants shall have the opportunity on

any review of the Commission's decision, to contend, as a matter of law, that Respondent must allow exclusion from Missouri adjusted gross income of Railroad Retirement Tier I benefits.

8. Respondent offered, and the Administrative Hearing Commission received in evidence, without a §536.070 (12), RSMo 1986, objection by Appellants, the following affidavit (omitted are venue and notary's jurat):

AFFIDAVIT

Comes now Keith Micke, being duly sworn, and states as follows:

1. My name is Keith Micke. I am employed by the Missouri Department of Revenue, and am assigned to the Office of Legislation and Regulations as a Legislative Analyst II.

2. At the request of the General Counsel's Office of the Department of Revenue, I have conducted research into the

amount of the tax paid on social security benefits to the state of Missouri.

3. Information compiled by the College of Business and Public Administration at the University of Missouri-Columbia for tax year 1988 reflected that $263,100,000 that was received in social security benefits was included in the Missouri adjusted gross income of Missouri taxpayers.

4. The majority of these benefits are taxed at the 6 percent rate because benefits are not taxed at the federal level until income reaches $25,000 for a single person or $32,000 for a married couple.

5. Accordingly, approximately $15,786,000 was paid in tax on social security benefits for tax year 1988 to the state of Missouri.

Further Affiant saith not.

s/s Keith Micke
Keith Micke

9. This Abbreviated/Partial Record on Appeal, a copy of which is being filed with the Administrative Hearing Commission, shall be subject to supplementation and correction as provided in Rule 81.12(e).

Respectfully submitted,

/s/ Gilbert Carter
Attorney for Appellants

/s/ George Cox
Attorney for Respondent

SUPPLEMENTAL RECORD ON APPEAL

Pursuant to paragraph 9 of the Abbreviated/Partial Record on Appeal, the parties agree as follows:

Pursuant to the Missouri income tax instructions for tax year 1987, numerous taxpayers in their Missouri income tax returns for that year excluded from their Missouri adjusted gross income the portions of their Tier I Railroad Retirement benefits they had included in their federal adjusted gross income in compliance with IRC §86, and thereby were relieved of

payment of Missouri income taxes they otherwise would have incurred on such benefit portions.

/s/ Gilbert Carter
Gilbert Carter

/s/ Dan Cook
Attorney for Respondent

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As the Code § 86 tax rules now stand, tax-exempt interest is to be taken into account in determining the income threshold for taxing benefits. These provisions cleared Congress after generating heated debate both on the floor of the Senate and during the Conference Committee's consideration of the 1983 social security bill. And the battle still continues.

Senator Alfonse D'Amato of New York is the sponsor of a proposal (S. 1113) that calls for repeal of the tax-exempt interest

provision. A hearing of this bill was held in early August before the Senate Finance Subcommittee on Social Security and Income Maintenance Program at which both proponents and opponents testified. Senator D'Amato stated that "The Congress erred in adding to the [President's Commission on Social Security Reform] recommendations what amounts to an unconstitutional, improper, and unfair tax to be borne primarily by middle class taxpayers and senior citizens of our society."

* * *

The principal problem with the formula for taxing benefits, Pearlman stated, is that it imposes high marginal tax rates on individuals in the phase-in range (i.e., individuals with income of roughly between $20,000 and $35,000 (excluding benefits) and couples with incomes of roughtly between $27,000 and $42,000 (excluding

benefits)) who are taxed on a portion, between zero and one-half, of their benefits. This happens because an individual in the phase-in range who earns an extra dollar finds not only that the extra dollar is taxed but also that an additional 50 cents of his benefits is taxed.

* * *

As can be seen from the above two examples, the additional $100 of income results in a $150 increase in income that will be subject to tax. Assuming that Tom is in the 35% tax bracket, the additional $100 of income would normally result in a tax increase of $35. But under the social security benefit tax formula, the tax increase is $52.50 (35% X $150).

The above problem is even more serious if an individual is affected by both the phase-in of the benefit taxation formula and the social security earnings test

formula for reducing social security benefits. In that case, an individual can find that by earning an extra dollar, not only is he taxed on more than a dollar, but he also loses some social security benefits. In such cases, a person could actually lose money by earning an extra dollar.